

WALTERS & ASSOCIATES, INC

Specialized Financial Consulting to the Communications Industry

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Dr. Bernadette McGuire-Rivera
Associate Administrator, NTIA
United States Department of Commerce
1401 Constitution Avenue, N.W.
Washington, DC 20230

Dear Dr. McGuire-Rivera,

Walters & Associates, Inc. is pleased to submit the following recommendations and comments for consideration by the NTIA in developing rules for the Broadband Technology Opportunities Program.

Walters & Associates, Inc. is a nationally recognized telecommunications industry valuation firm with expertise in spectrum valuation issues. Our firm has advised the Federal Communications Commission, National Telecommunications and Information Administration and United States Department of Treasury staff on telecommunications business and spectrum valuation issues. I have also provided expert testimony in valuation proceedings in the United States Tax Court, United States Bankruptcy Court, Federal Trade Commission and in various state and Federal Courts. In addition, the Internal Revenue Service retained our firm as an expert valuation witness. I was instrumental in developing the valuation methodology for Federal Communication Commission (FCC) license valuations. This valuation approach was accepted in the Jefferson-Pilot Corporation FCC license amortization case decided by the U.S. Tax Court on April 14, 1992. For over 30 years, I have been involved exclusively in the telecommunications industry and am well acquainted with the issues and concerns of broadband service providers, policy makers, the technical community and commercial and governmental license holders.

Recommendations

(1) The value of a licensee's radio frequency spectrum will be considered in meeting the applicant's 20.0% contribution towards a Broadband Technologies Opportunities Program grant award.

(2) The fair market value of a licensee's radio frequency spectrum used towards meeting the 20.0% grant contribution shall be determined by a qualified appraisal prepared by an independent, qualified appraiser unaffiliated with the licensee. The definition of "qualified appraisal" and "qualified appraiser" shall conform to the definitions established by the Department of Treasury Internal Revenue Service.

The purpose of our recommendations are twofold: First, to recognize that a licensee's radio frequency spectrum has a clear and measurable value that needs to be considered in a wireless carrier's grant proposal to bring broadband service to an unserved or under-served area. Secondly, to provide a mechanism to ensure that an applicant's assertions as to the fair market value of its spectrum authorities will be determined by an independent, qualified, third party valuation professional unaffiliated with the licensee. A full discussion in support of our recommendations is contained in the following paragraphs.

Spectrum Value Contribution for Matching Funds

The Broadband Technologies Opportunities Program (BTOP) Section 6001 (f) establishes the Federal share of any approved broadband deployment project to be limited to 80.0% of the value of the project. Section 6001 (g) identifies the items for which the stimulus grants can be made. These items are generally restricted to the acquisition of "equipment, instrumentation, networking capability, hardware and software, digital network technology, and infrastructure for broadband services." The eligible items are further defined to be those used to "construct and deploy broadband service related infrastructure."

Absent from the enumeration of items which the Federal grant money can be spent on is radio frequency spectrum necessary for the deployment of wireless broadband services. ***Because radio frequency spectrum is a necessary component of any wireless broadband deployment, the value of such spectrum should be considered in the calculation of the 20.0% required contribution by a wireless service provider or licensee.***

Radio Frequency Spectrum Value to the Treasury

The fact that radio frequency spectrum is a valuable asset is well established by both Federal Communications Commissions sanctioned auctions and by private market sales. The Omnibus Budget Reconciliation Act of 1993 gave the FCC authority to use auctions to award licenses to the highest bidders. Since that time it has been the policy of the FCC to use auctions as the most fair and efficient manner in which to award license authorities. According to FCC policy analysts, "auctions assign licenses quickly to those who value them the most, employ objective, transparent criteria, reduce wasteful private expenditures on obtaining licenses, and raise revenue for the public."¹ Investors have paid material amounts for radio frequency spectrum through the auction process. Since the first auction in 1994, the FCC has generated approximately \$77.0 billion for the US Treasury.² In addition to auction revenue, the Treasury has been the beneficiary of substantial revenue generated by the capital gains tax on the private market sale of spectrum authorities to major carriers following the auctions.

¹ Auctioning Spectrum Rights, Evan Kwerel, Office of Plans and Policy and Walt Strack, Wireless Telecommunications Bureau, U.S. Federal Communications Commission February 20, 2001.

² Source: Federal Communications Commission Auction 1 to Auction 85 net revenue data.

Radio Frequency Spectrum Value to the Telecom Industry

Most publicly traded telecommunications companies routinely report the value of their spectrum authorities on their balance sheets as a part of their quarterly and annual 10-Q and 10-K Securities and Exchange Commission reporting requirements. The value of each public company's spectrum authorities is periodically reviewed to determine if there has been any impairment to the value of the spectrum assets. If so, this information is disclosed to the public. Details of the acquisition or sale of spectrum authorities are also routinely disclosed by carrier companies, as well as the competitive spectrum position a company may hold in its market areas. The value of a company's radio frequency assets is important in determining the overall value of the company and the valuation methods used to establish or confirm these amounts are well understood by the accounting and valuation community, who report this information to the public.

The value of a company's spectrum assets is also routinely considered in mergers and acquisitions. A recent example is the Clearwire merger agreement with Sprint-Nextel and other telecom industry investors. Sprint's contribution to the venture was approximately \$7.4 billion, which consisted primarily of the value of its 2.5 GHz spectrum assets. Intel, Google, Comcast, Time Warner and Brighthouse Networks, the other investors, contributed a total of \$3.2 billion in cash to the capitalization of the new company.³ In addition, as of December 31, 2008, Clearwire had a minimum of \$47.8 million in purchase agreements for additional spectrum.⁴

Radio frequency spectrum value is a well established balance sheet item for wireless carrier companies. The value of radio frequency spectrum assets is also used as currency in the capitalization of new business entities formed through mergers, joint ventures or acquisitions.

Radio Frequency Spectrum Value to the Educational Broadcast Service

There are over 2,000 Educational Broadcast Service (EBS) licenses in the 2.5 GHz band authorized by the FCC to approximately 1,300 educational entities throughout the United States. The holders of these licenses are state government agencies, state universities and university systems, public community and technical colleges, private universities and colleges, public elementary and secondary school districts, private schools, public television and radio stations, hospitals and hospital associations, and private, non-profit educational entities. One mission of EBS licensees in utilizing the licensed spectrum is to improve access to broadband services throughout the United States.⁵ The commercial value of EBS license authorities is well documented. Clearwire, along with Sprint-Nextel, have negotiated long term spectrum lease,

³ Clearwire Corporation Securities and Exchange Commission 10-Q filing, September 30, 2008.

⁴ Clearwire Corporation Securities and Exchange Commission 10-K filing, December 31, 2008.

⁵ Comments of the National EBS Association, Broadband Technology Opportunities Program (BTOP) of the NTIA, Docket No. 0903092928, April 7, 2009.

agreements primarily with EBS license holders, that have a current value of over \$5.0 billion.⁶ EBS licenses holders consist of state and governmental entities that are directly identified in Section 6001 (3) (A) of the BTOP as “entities to facilitate greater use of broadband service by or through these organizations”. The clear intent of the BTOP is to allow EBS licensees to participate either by themselves or through commercial partnerships to deploy broadband service to un-served or under-served areas. The EBS license authorities held by non-commercial public and private entities have measurable fair market values and should be considered for purposes of determining an applicant’s 20.0% grant obligation.

Consideration of Spectrum Value Will Result In More Efficient Use

Currently, the Federal Communications Commission imposes construction requirements for licensees. These construction requirements must be met in order for a licensee to retain its authority to use the spectrum. These construction obligations generally require the licensee to provide coverage of a specified portion of a geographic area or a portion of the population within the geographic license area. In the case of microwave transmission systems, the construction obligation is met if the licensee satisfies a “substantial service” requirement, which is based on a formula that requires a certain number of links to be placed in service based on the population within the geographic license area. The construction time periods and coverage formulas vary depending on the licensed service. Once a licensee meets its minimum construction or “substantial service” requirement, they no longer need to construct any additional transmission infrastructure in order to maintain their license authorities. This is why some rural fringe areas may not receive service from the geographic licensee. The carrier company has no further regulatory requirement to build out in rural areas and little incentive, other than profit motive, to construct additional facilities.

The Broadband Technologies Opportunities Program provides grants for broadband infrastructure equipment. Heretofore, commercial wireless carrier companies constructed facilities in areas where there was a general expectation that the company would receive a satisfactory return on investment. Service areas are left unconstructed primarily because the “business case” demonstrates that service to the area is not commercially viable. The availability of broadband infrastructure equipment, through the stimulus grant program, dramatically changes the “business case” equation for commercial wireless service providers. The opportunity presented by a material reduction in infrastructure costs will certainly result in commercial wireless companies re-evaluating their network deployment plans. The likely outcome will be for commercial wireless carriers to deploy their spectrum assets in areas that have not, as yet, been served. This will also motivate established commercial wireless carriers to seek out partnerships or joint ventures with other spectrum holders to provide service to un-served or under-served areas. These activities serve to accomplish not only the goals of the broadband stimulus program, but will provide fuller use of spectrum assets controlled by both commercial and non-commercial entities.

⁶ Clearwire Corporation Securities and Exchange Commission 10-K filing, December 31, 2008.

Spectrum Value Shall Be Determined By Qualified Appraisals

Radio frequency spectrum constitutes an important asset for commercial wireless carriers and an important revenue sources for non-commercial licensees. These assets will need to be deployed in order to provide broadband service to un-served and under-served regions of the United States. The fair market value of radio frequency spectrum can be determined with reasonable accuracy. Spectrum valuation methods are generally accepted and well understood by carrier companies, accountants and valuation professionals. As such, the fair market value of a licensee's spectrum authorities should be considered for purposes of meeting the applicant's 20.0% contribution.

Telecommunications businesses are capital intensive. It is expected that infrastructure grant requests will be for material amounts. This could provide a motivation for some licensees to inaccurately state the fair market value of their spectrum holdings slated for deployment. To mitigate the possibility of any inherent conflict, it will be the NTIA's responsibility to institute rules that require that a fair market valuation assertion, used in a grant applicant's 20.0% contribution, must be determined by an independent third party, unaffiliated with the applicant. This stipulation is a necessary requirement to ensure that taxpayer monies are fairly allocated to companies performing broadband network deployments.

The Internal Revenue Service, a division of the Treasury Department, routinely assesses the claims of individual and corporate taxpayers seeking income tax deductions for donations of property and other items. The Internal Revenue Service has extensive experience assessing the accuracy of fair market valuation claims and has developed a number rules and regulations to protect the interests of the Treasury. These same rules and regulations can be used to provide guidance to the NTIA in establishing the procedures and requirements for establishing the value of radio frequency spectrum (or other applicant contributions). Internal Revenue Service Publication 561: Determining the Value of Donated Property provides a clear discussion of fair market value and examples of acceptable valuation methods. The definitions and valuation methods described by the Internal Revenue Service are generally understood, accepted and followed by the professional valuation community. The NTIA will be well served to follow the guidance of the Internal Revenue Service in any matter in which applicants present fair market value evidence in order to support broadband grant money requests.

The Internal Revenue Service rules require that a "qualified appraisal" be performed by a "qualified appraiser" for donated property that has a value that exceeds \$5.0 thousand dollars. For property valuations that exceed \$500.0 thousand dollars, the IRS requires that a copy of the appraisal report be submitted along with the tax filing. The IRS has defined a "qualified appraiser" as an individual that has earned an appraisal designation from a recognized professional appraisal organization for demonstrated competency in valuing the type of property being appraised; has met minimum education and experience requirements; regularly prepares appraisals for which he is paid; and demonstrates verifiable education and experience in valuing the type of property to be

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appraised. The “qualified appraiser” must sign a declaration attesting to the fact he meets the IRS qualifications and is subject to financial and civil penalties for valuation misstatements.⁷ The IRS also specifically excludes an individual as a “qualified appraiser” if the person making the appraisal is either the donor or donee of the property, is the taxpayer filing for the deduction, is any party to the transaction, a person employed by any party to the transaction or is any one married to a party to the transaction.

The IRS has defined a “qualified appraisal” as a signed and dated document prepared by a “qualified appraiser”. It must be prepared no earlier than 60 days before the contribution and the fee for the appraisal can not be based on a percentage of the appraised value. The appraisal must contain a complete description of the property, the name and qualifications of the appraiser, a statement that the appraisal was made for income tax purposes, the valuation date, the method of valuation used to determine the fair market value and the basis for the valuation, such as comparable sales.

The rules and regulations developed by the IRS to support fair market valuation claims have evolved in order to inhibit fraud and abuse and to protect the Treasury. These rules and regulations provide an orderly framework for taxpayers, accountants, valuation professionals and Internal Revenue Service employees to evaluate and substantiate fair market value claims. Walters & Associates, Inc. strongly encourages the NTIA to accept these same guidelines to ensure that fair market value claims used in the preparation of grant applications are impartial, independent and verifiable.

Respectfully submitted,

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CEW/hs

cc: Anna Gomez, Acting Administrator, NTIA
Mark Siefert, Senior Advisor, NTIA
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⁷ Internal Revenue Service Publication 561: Determining the Value of Donated Property